Weekly


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The market's lack of movement - the S&P is unchanged since the beginning of April - is indicative of all the headwinds out there.

Heading into this most recent week, the S&P had closed within a tiny range for three straight weeks. But although the S&P was near its high, it had closed off its high and formed a bearish weekly candle. The proximity to the high told us something; the weak close told us something else.

Most indicators had moved up with force and were sitting at high levels - in some cases levels that hadn't been seen in many months. But negative divergences were starting to form on a few of the breadth indicators. The high prints were characteristic of a strong and healthy market that was well-supported and trending up. But they also told us the market had probably run enough and was in need of a rest...and the divergences told us the participation rate on the most recent leg up declined.

The latest Fed meeting came and went without any disruption. The Fed kept rates the same, stating the same old same old and making sure they mentioned "world events" as a reason to keep rates where they were. Of course the world events they referred to is the vote in Great Britain to stay or leave the European Union. The vote is supposed to take place next Thursday, but there's talk it may be delayed. You could say a big week is in the books (Fed week), and an even bigger week is coming (Brexit vote).

Let's talk about the ramifications of Great Britain leaving the EU. It is much more significant than a measly 25 basis-point move in the Fed funds rate. Rates can be moved up and down pretty easily, and other than a relatively minor stock market move, a single rate hike is almost meaningless in the grand scheme of things. But if Great Britain leaves the EU, a drastic change will take place that will last decades, and if other countries follow, the entire block will unravel.

The EU is a union of 28 countries. On the street level, citizens of the countries are free to travel and work in other EU countries. At a higher level, the countries trade more freely with each other (no tariffs) and because they represent over 500 million people, it's easier to negotiate trade deals with the US, China and others. But when big countries and small countries, wealthy countries and much less wealthy countries form a group and act as one, not everyone is going to be happy at all times.

I see three main benefits to being part of the EU. 1) Tariff-free trading with other member states. Britain trades more with other EU countries than it does with the US or any other country. There are 500 million EU citizens. To have access to them in a smooth and tariff-free manner is a big benefit. 2) The EU as a whole, because of its size, can better negotiate with the US, China, Russia and Brazil. They get cheaper natural gas from Russia and can maintain easier access to the huge US consumer market. If they had to go it alone, they wouldn't get nearly the same deals, if they got deals at all. 3) Access to talent. Those carrying EU passports can work in other EU countries. Britain, being one of the strongest and most desirable places to work, can attract talent from all over Europe.

There are of course drawbacks to membership - this certainly is not an exhaustive list. 1) Each country loses some autonomy. They don't get to make their own rules and often have to follow rules they are opposed to. 2) There are share expenses and distribution of wealth that work against Great Britain. Being one of the wealthier and most desirable members of the block means the distribution of resources works against Great Britain. They send more money to the EU than they get back. This works in the US (Mississippi gets $3 for every $1 it sends to Washington) where wealthier states subsidize poorer states, but it doesn't sit well with sovereign nations. And citizens of poor countries move to Britain and end up collecting welfare, which puts a lot of stress on the system.

These are the main considerations British voters have to weigh. Membership in the EU is costly financially and in terms of losing some of their sovereignty. But they can freely trade tariff-free with other EU nations and can be part of a block that can negotiate better deals with much larger nations.

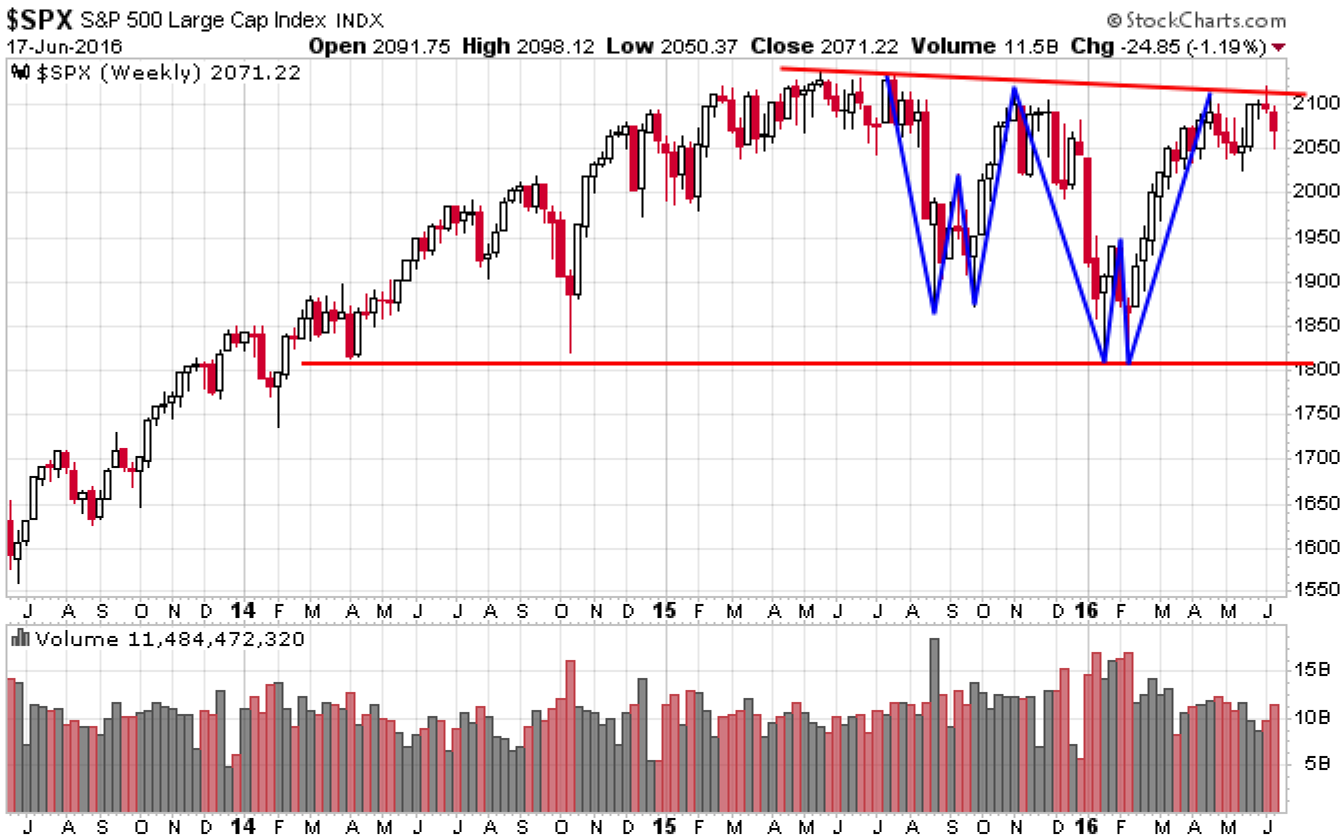
Are the costs worth the benefits? For some, it may not matter. They may oppose it from a philosophical standpoint regardless of the benefits and drawbacks.

If Great Britain chooses to leave the EU, in the long run they'll probably be fine on their own. The bigger fallout comes from other countries leaving and the possibility the entire block unravels. It's way beyond the scope of this report to discuss such a chain of events, but I can say uncertainly would skyrocket - exactly what the market doesn't like.

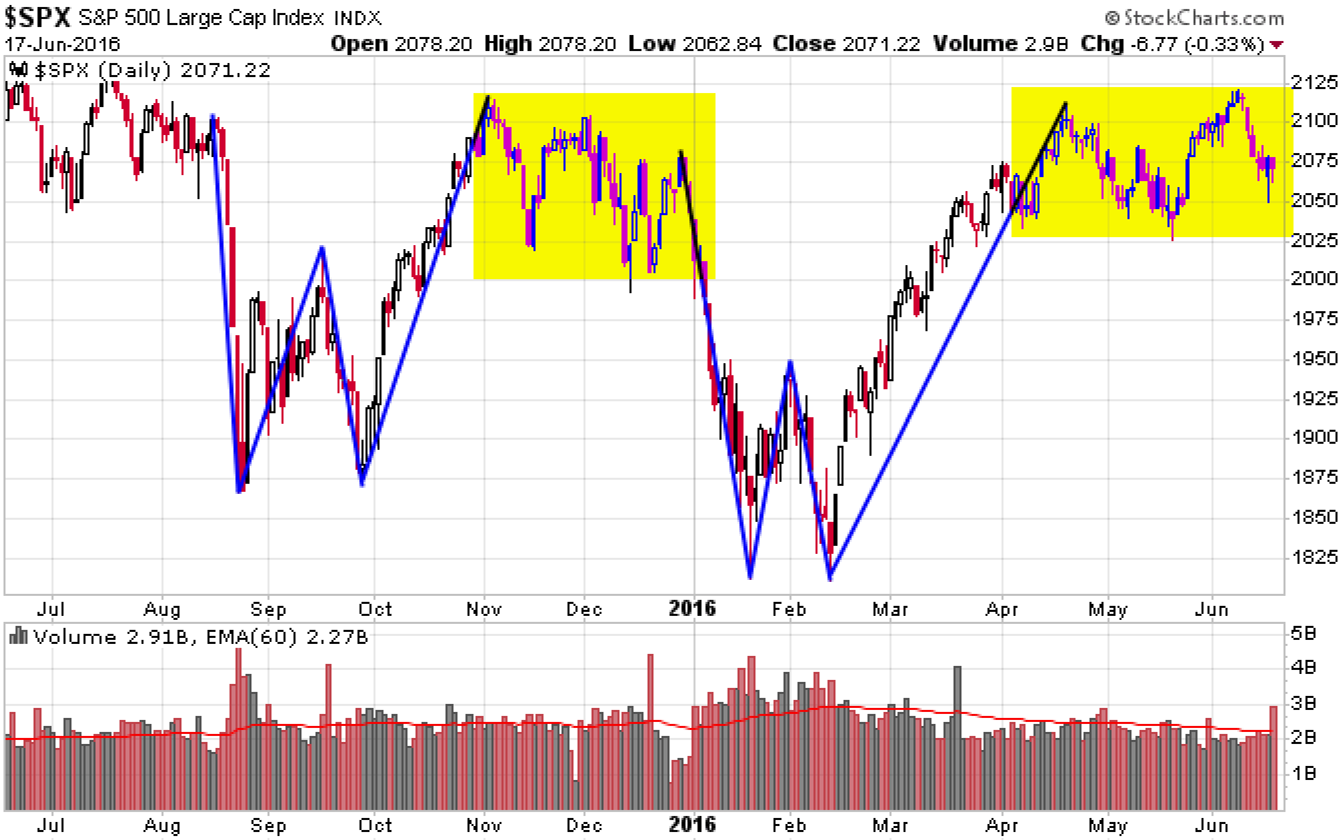
The market is discounting all this. Let's see what the charts say. Are there any subtle hints beneath the surface?

**Indexes**

**The S&P 500 Weekly:** Last week was the biggest down week since April, but thanks to a big reversal rally Thursday, the market closed well off its lows. The big picture says the market has been in a range for 2+ years. We've also been in a range shorter term (last couple months). The bulls will say the size of the range measures up 300 points. The bears will cite a long list of reasons it's not possible or shouldn't happen. In my eyes the overall trend is up until the internals deteriorate in a way that tells me something is seriously wrong beneath the surface.

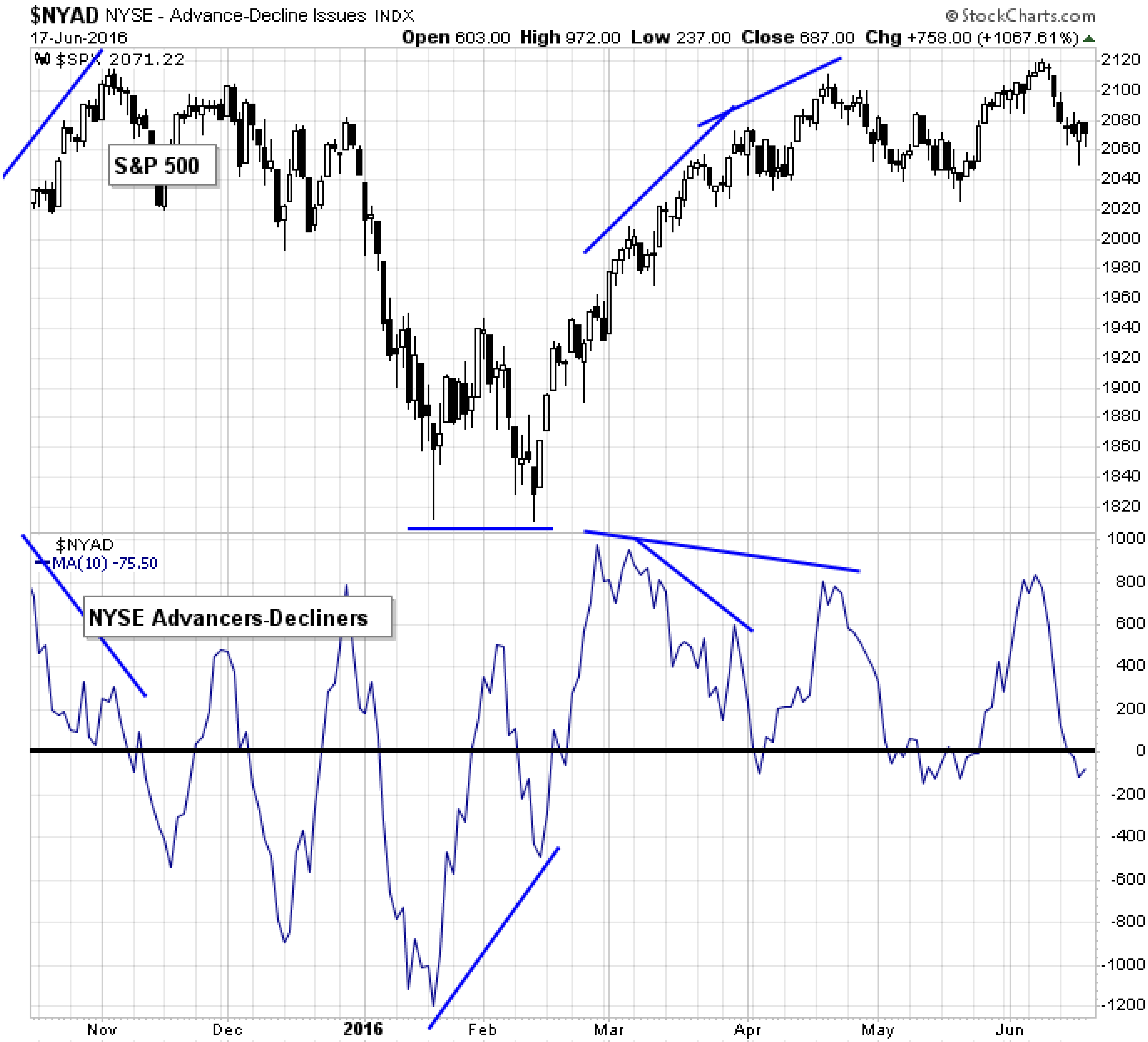


**The S&P 500 Daily:** The market fell 4 of 5 days last week and is now sitting in the middle of its range. Do you want to have a strong opinion? Ahead of the vote in Great Britain? Go for it.



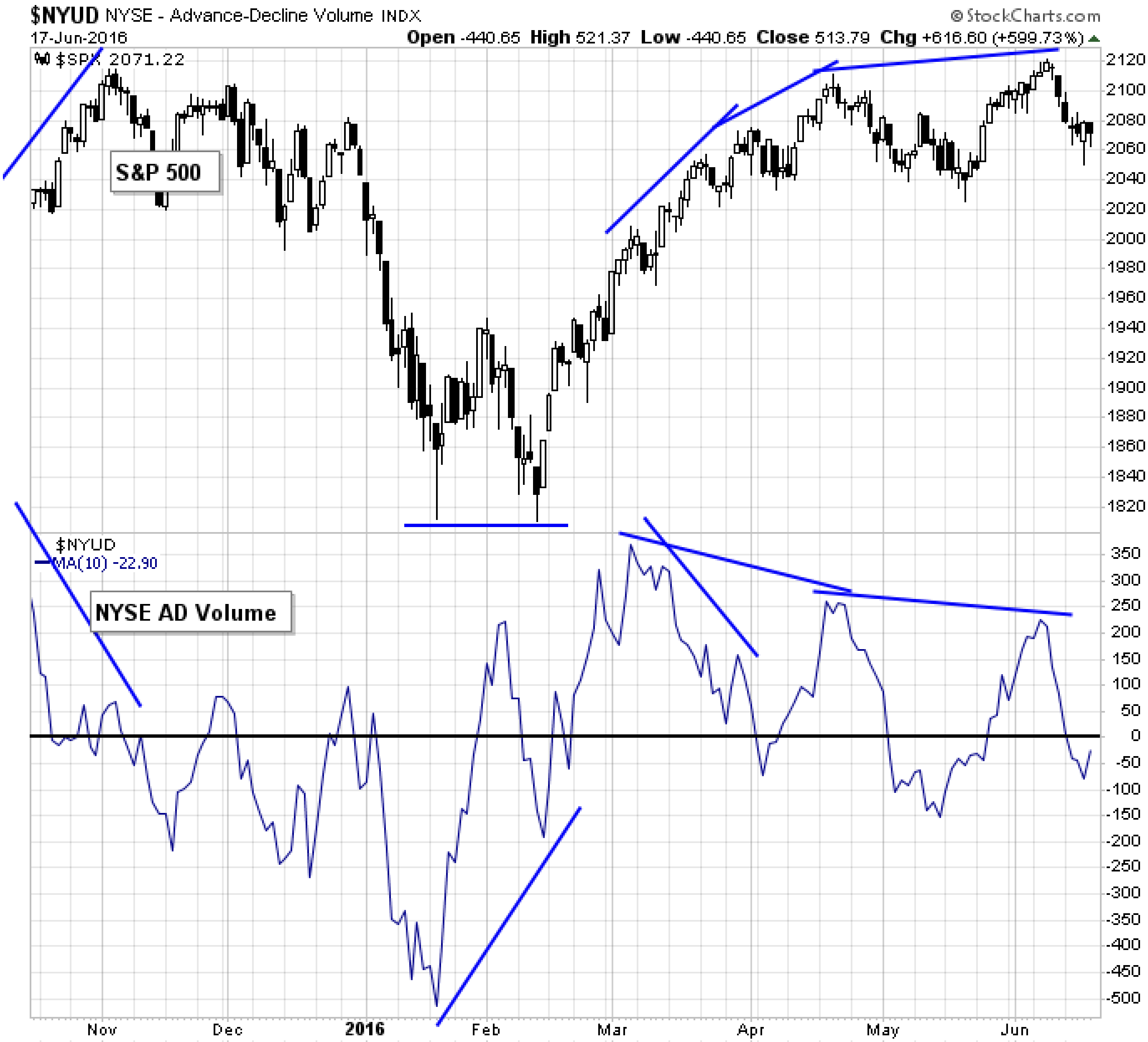
## Indicators

**S&P 500 vs. 10-day MA of NYSE AD Line:** An up-trending market is typically characterized by a 10-day AD line which oscillates between 0 and a high level. This has been the case the last four months. As of now, the current correction looks more like a drop within an uptrend, not the beginning of a leg down. This will change if the AD line takes out its low and suffers a deeper penetration of 0.



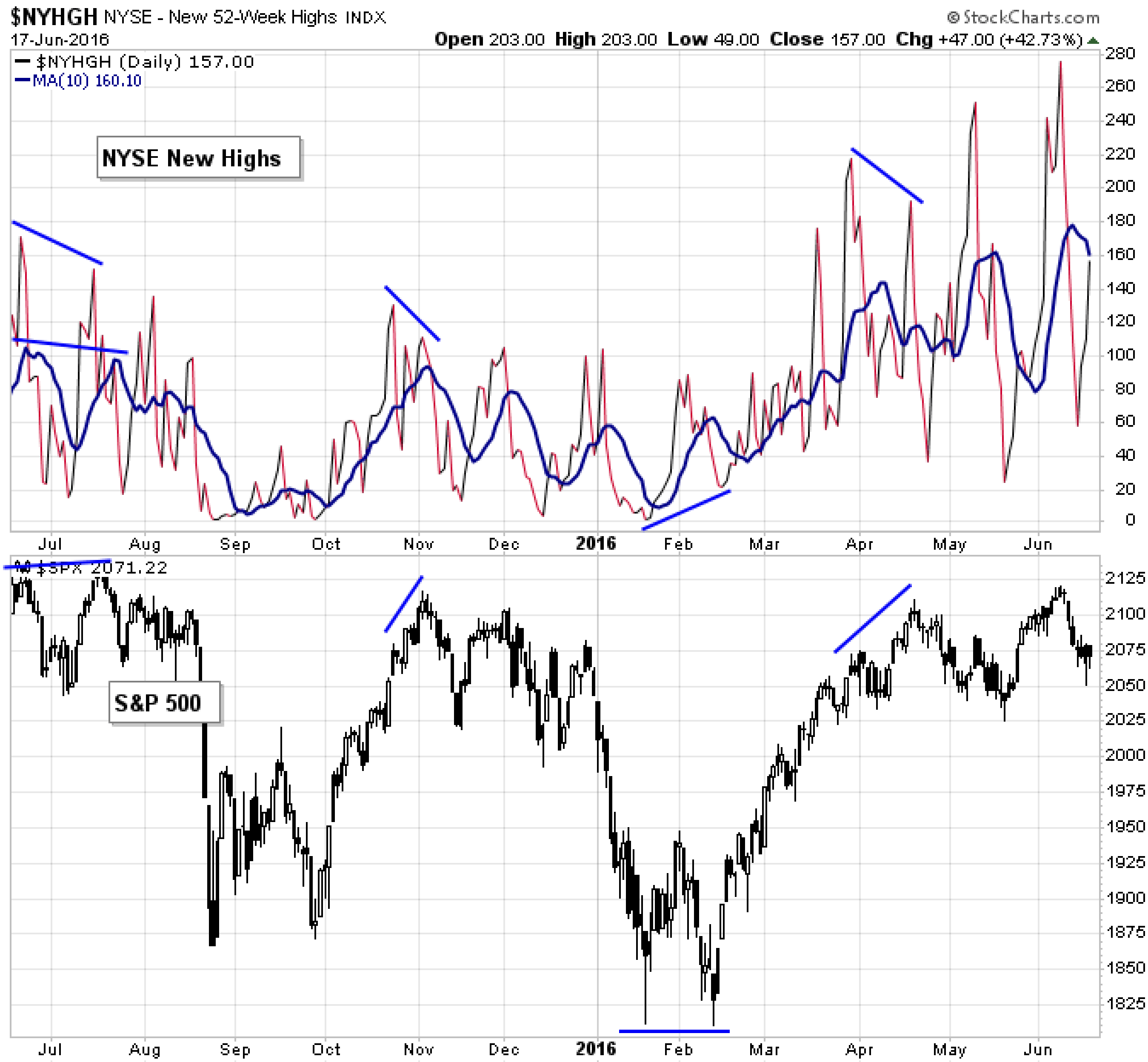
**S&P 500 vs. NYSE Cumulative AD Line:** The cumulative AD line looks great. Unlike last summer when the indicator trended down while the market traded range bound, the indicator remains in a solid uptrend.

**S&P 500 vs. 10-day MA of NYSE AD Volume Line:** The AD volume line, which lets the higher-volume stocks have more influence, is acting similarly to the AD line, which treats all stocks equally. The current dip below 0 is acceptable for healthy market acting well. A deeper move down would be a warning.

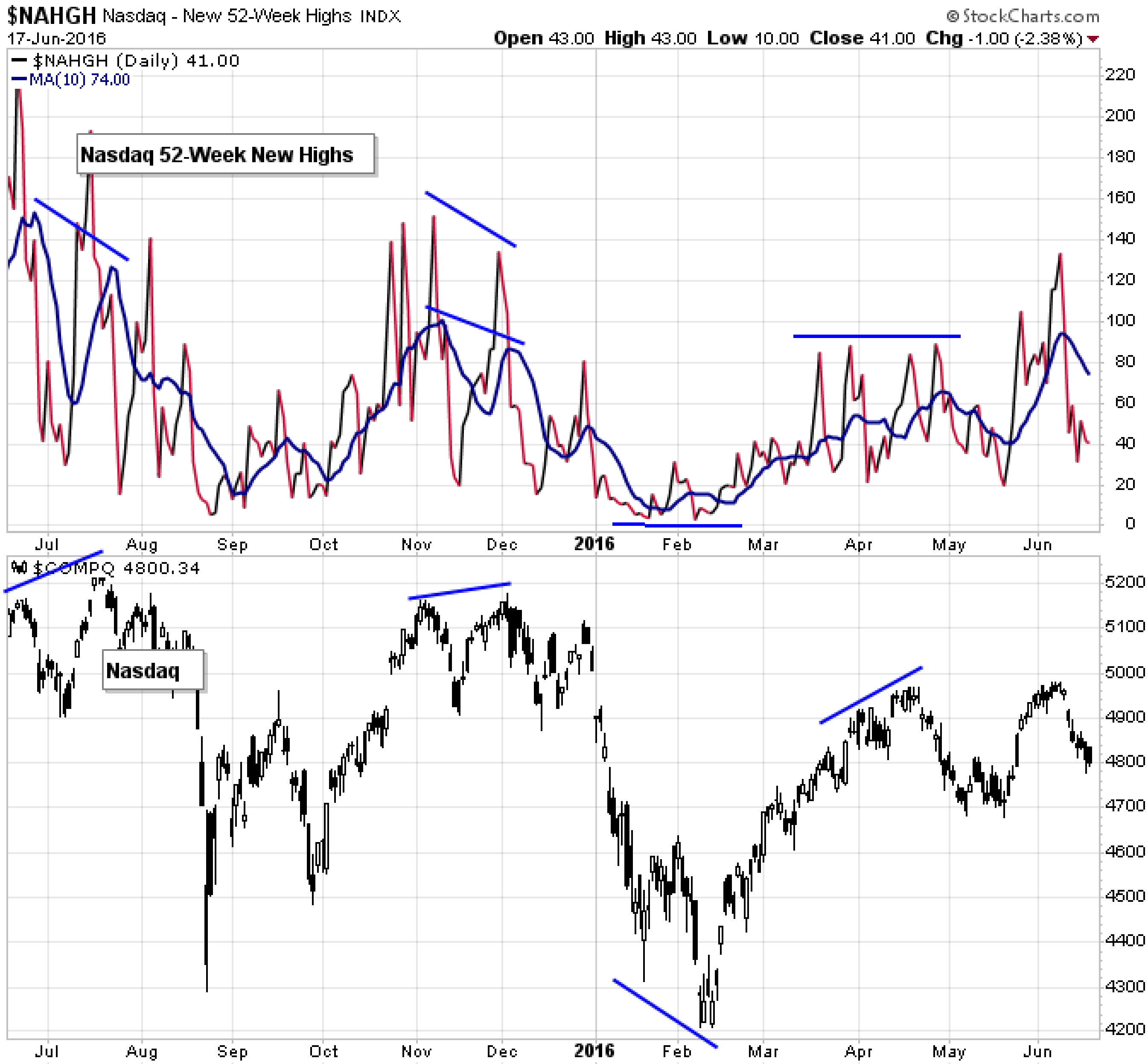


**S&P 500 vs. NYSE Cumulative AD Volume Line:** No divergence and no series of lower highs and lower lows. Per the cumulative AD volume line, the market remains in good shape.

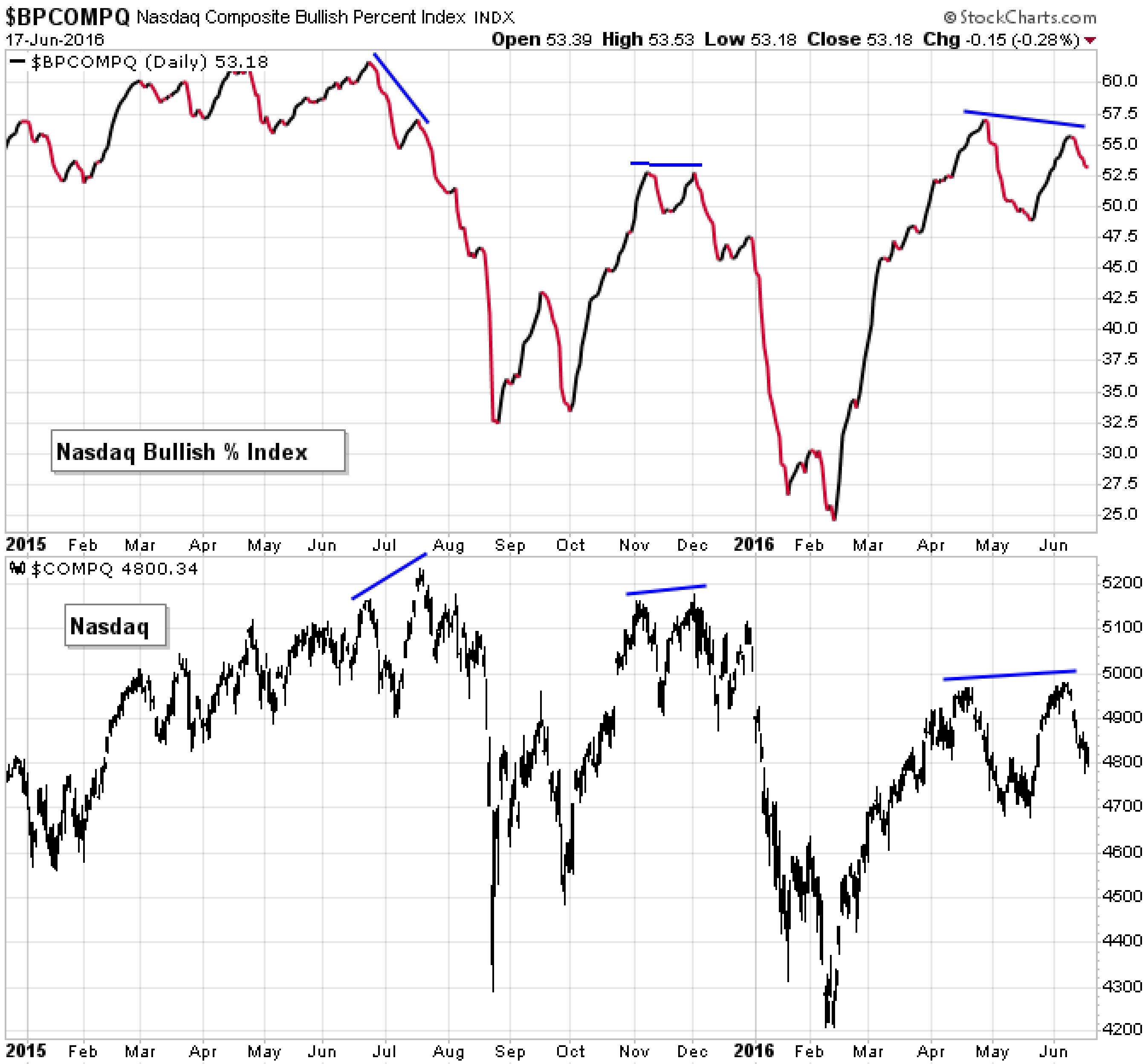
**S&P 500 vs. NYSE New Highs:** New highs at the NYSE have dropped but haven't plunged to an extremely low level. I'd consider this to be perfectly normal for a healthy market. If we bounce off the lows, we'll want to see new highs expand soon after.



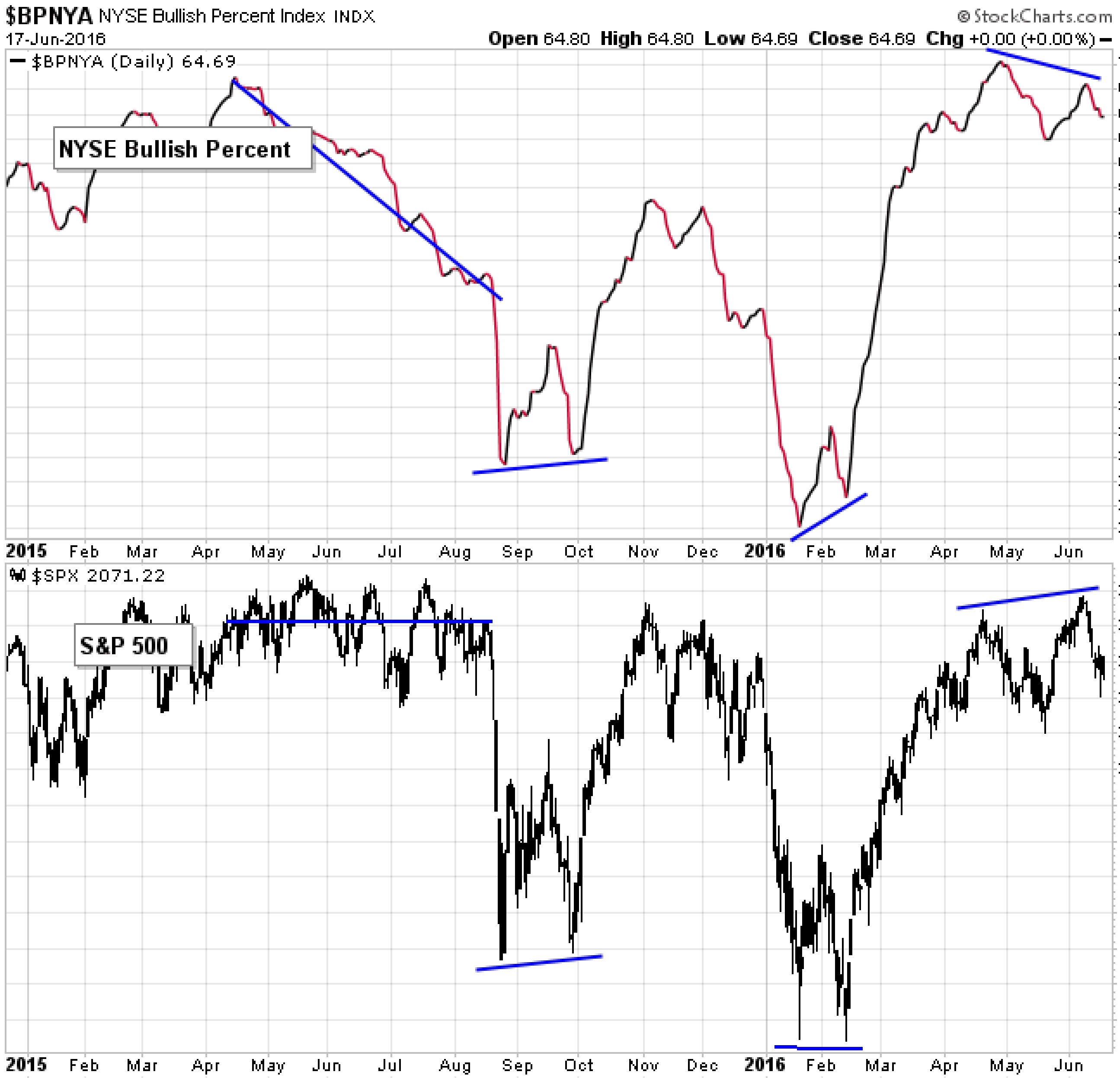
**NASDAQ vs. NASDAQ New Highs** New highs at the Nas have been much worse off. They jumped at the end of May and beginning of June but overall have been nonexistent. Some believe the S&P is going to break out and run up to 2300 or 2400. For this to take place, new highs at the Nas will need to ramp up.



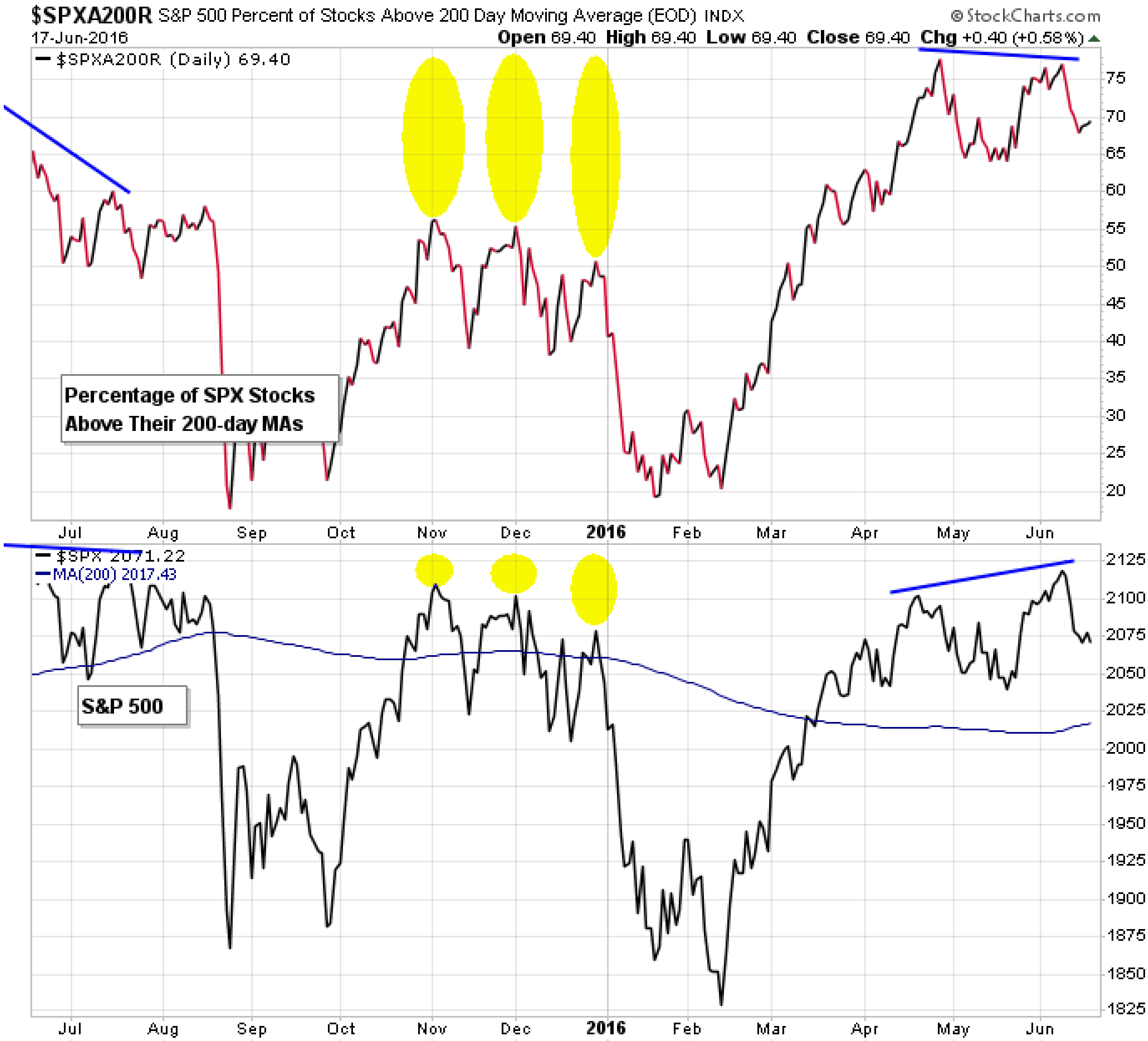
**NASDAQ vs. NASDAQ Bullish Percent:** The Nas bullish percent is still working off its negative divergence. The market would need to be incredibly strong to resist falling further. Cycle down further wouldn't damage the charts too much. The market has its own clock; if it needs to rest further, it will.



**S&P 500 vs. NYSE Bullish Percent:** The NYSE bullish percent is also working off a negative divergence, albeit from a much higher level. Slightly less stocks participated in this most recent rally. It's not a deal breaker. It doesn't mean the uptrend is permanently over. It just means a correction was likely...and that's exactly what we've gotten.

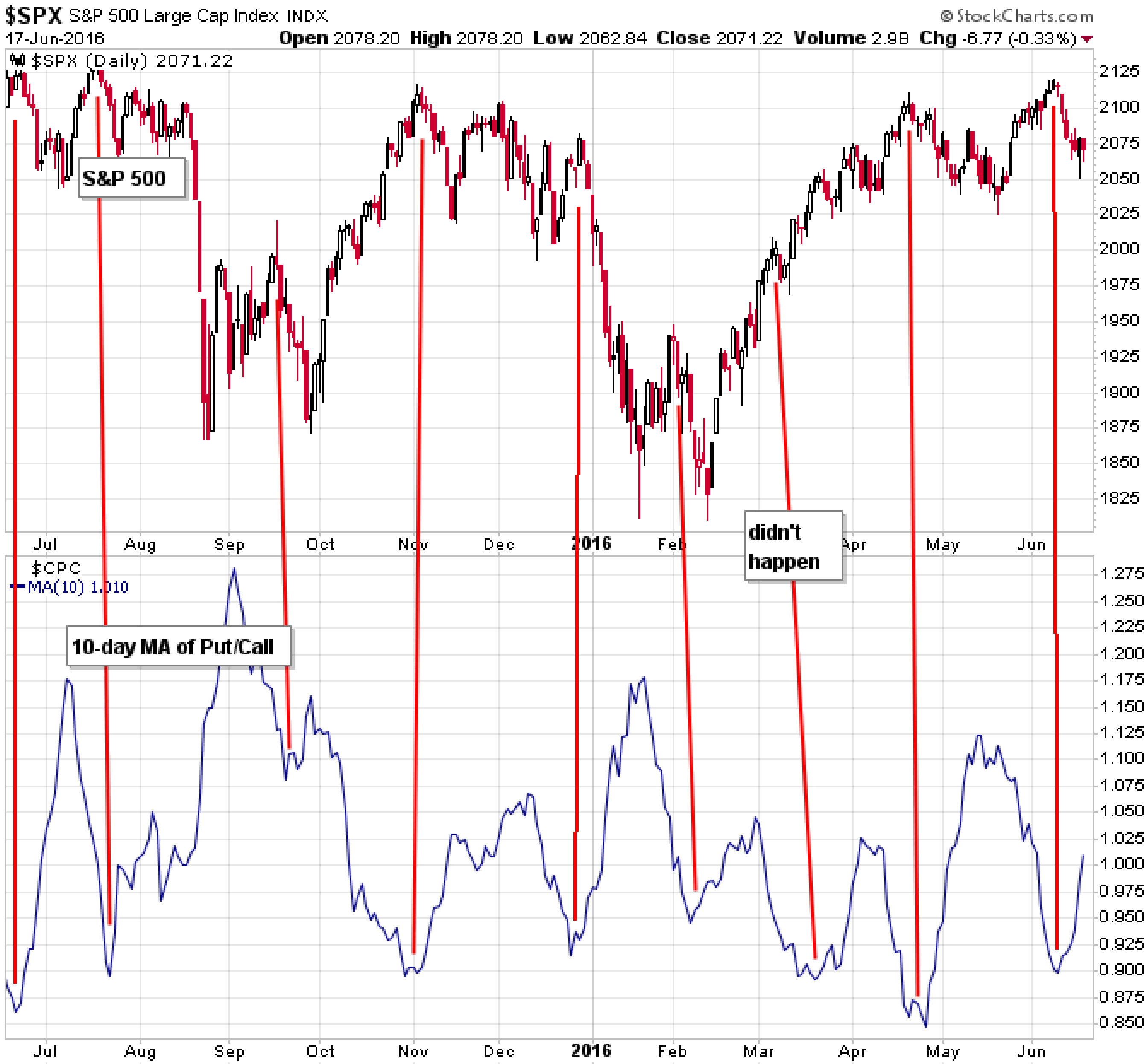


**S&P 500 vs. Percentage of SPX Stocks Above 200-day MA:** When the S&P pushed to a higher high two weeks ago, less stocks were above their 200-day moving averages. By a small margin, the participation rate declined. This will only become a big issue if the May low is taken out. Otherwise I consider this indicator to be sitting at a healthy level.

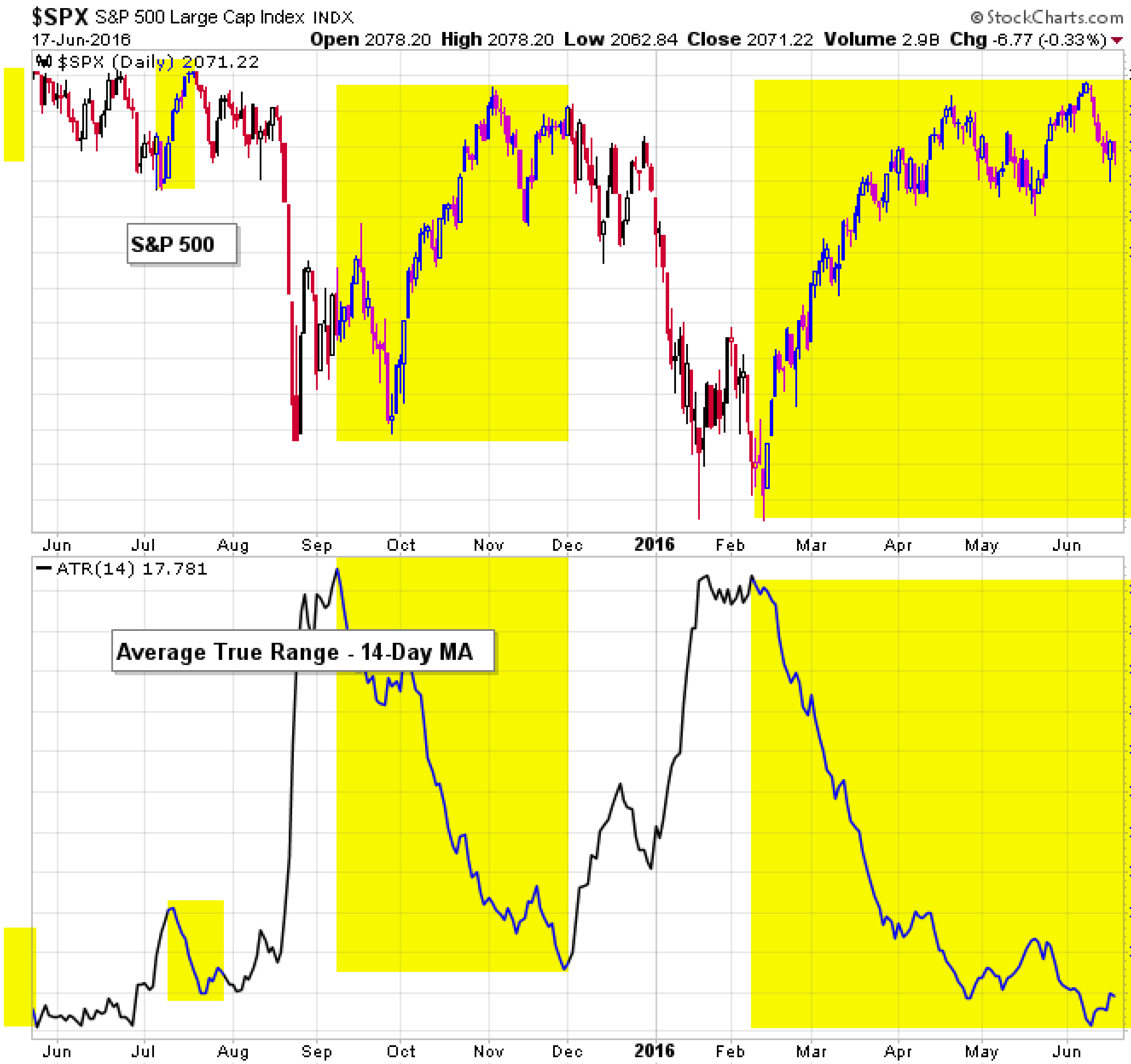


**S&P 500 vs. Percentage of SPX Stocks Above 50-day MA:** The obvious decline in number of SPX stocks above their 50-day MAs was a big warning when the market pushed to a higher high earlier this month. Now the indicator has cycled down and is trying to curl up. The S&P is right at its 50, and the percentage of SPX stocks above their 50's is at 50% - exactly what you'd expect. Whatever the market does from here, this indicator will either confirm or reject the move.

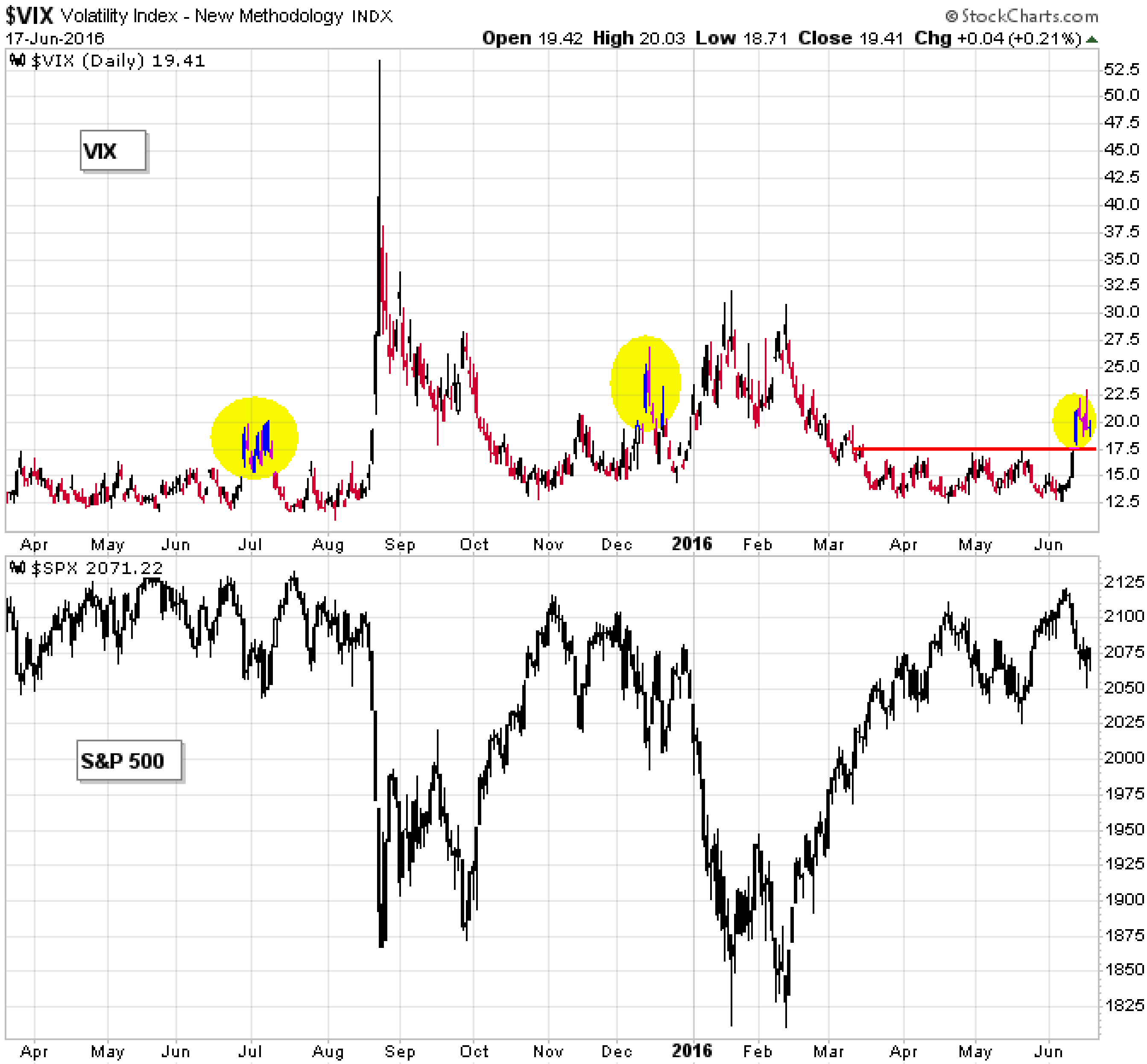
**S&P 500 vs. 10-day MA of Put/Call Ratio:** Like clockwork, the 10-day of the put/call curled up at the same time the market topped and rolled over. It still has room to move up before being considered ready to reverse and support a market rally. That's what I'm looking for. A market bounce must be accompanied by the PC rolling over; otherwise the bounce won't go far.



**S&P 500 vs. 14-day Average True Range:** As long as the ATR either trends down or hangs out at a low level, the market's strength will be supported. The market moves up on low volatility and down on surging volatility. Right now vol is very low.



**S&P 500 vs. VIX:** I noted this last week and still consider it worrisome. When the market trades in a range, as it has for the last couple months, and there's a sudden VIX spike, it warns of something brewing beneath the surface. It happened last June/July and again in December. In both cases, the market plunged 4-6 weeks later.



**US Dollar:** The US dollar may be a good proxy of what the Brexit vote may be - or what it's anticipated to be. If Great Britain leaves the EU, the pound will drop and the dollar will jump. Right now it's not happening. Polls favor leaving, but the market doesn't believe it.


## The Bottom Line

The market is in limbo. The S&P moved down to a lower low in the middle of May and up to a higher high two weeks ago and is now unchanged since the beginning of April.

The Fed is out of the way, but the Brexit vote looms.

The market's next move is not obvious. Some indicators have cycled down and are ready to support a bounce attempt, but others would benefit from continued deterioration before attempting to reverse.

This is not a time to go all in. I favor the upside overall, but in the near term it's coin flip. No big bets right now.

Have a great week.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